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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 133

ROBERT H. CORY,

Petitioner,

—*against*—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

PETER V. D. VOORHEES,
SAMUEL B. STEWART, JR.,
Counsel for Petitioner.

Hallsby Press, New York City

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

PETITION.

Your petitioner, Robert H. Cory, respectfully shows:

This is a petition for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit to review a decision affirming a decision by the United States Board of Tax Appeals finding deficiencies in your petitioner's income tax for the years 1935 and 1936 in the respective amounts of $3,802.02 and $9,074.76.

I.

STATEMENT OF FACTS.

[Otherwise unidentified numbers in parentheses refer to pages of the Record.]

This case arises out of the creation by the petitioner of four trusts of securities for the primary benefit of the petitioner's wife and three sons, respectively. The order below is based upon a finding that the trust income should be taxed to the grantor for two years of a ten year period after the trusts had been made irrevocable except with the consent of the beneficiaries.

On April 6, 1929, the petitioner (hereinafter called "Cory") created the trusts in question, with Clinton H. Blake as sole trustee (6). The original trust instruments reserved to Cory a limited right to amend or revoke the trusts (Exhibits B, C, D and E, 26-44), but on January 8, 1935, Cory amended each of these trusts so as to provide that it should continue for a further maximum period of ten years from that date, should be absolutely irrevocable except with the consent of the beneficiary and that on termination the principal should be distributed to Cory or his estate (Exhibits H, I, J and K, 45-53).

The Commissioner Admits He Originally Determined Deficiency on Erroneous Basis.

The Commissioner originally determined deficiencies in Cory's income tax liability for the years 1935 and 1936 by treating the income of these trusts as taxable to Cory by virtue of Section 166 of the Revenue Acts of 1934 and 1936, on the theory that Cory's remainder interest in each trust was equivalent to the retention of power to revest title in

himself (24, 62), but at the hearing in the Board of Tax Appeals the Commissioner admitted that he had been in error in his theory that the trusts were revocable trusts, and moved to amend his answer to claim that the deficiencies should have been determined on the ground that Cory was the beneficiary of the trusts and that the income was taxable to him under Section 22(a) of the Revenue Acts of 1934 and 1936 (72-74). This motion was granted.

Cory's reply to the amended answer in each case admitted the Commissioner's allegation that the original determination was erroneous, but denied that the petitioner was the beneficiary or owner of the trusts so as to be taxable under Section 22(a) of the Revenue Acts of 1934 and 1936 (74-75).

The Commissioner Had the Burden of Proof.

In accordance with Rule 32 of the Rules of the Board of Tax Appeals, both the Board and the Circuit Court of Appeals ruled (76, 110, 117) that the Commissioner, having pleaded an affirmative issue, had the burden of proof in establishing taxability of the income to Cory under Section 22(a).

Commissioner's Evidence.

The Commissioner presented no evidence other than copies of the trust instruments and the amendments thereto (78-80).

Cory's Evidence.

Cory presented the following evidence: (1) that he had filed a gift tax return for the year 1935 in which he had set forth the facts as to the amendment of the trusts in 1935, but had denied that such amendments effected taxable

gifts (81-83; Pet. Ex. 1, 92-95); (2) that the Commissioner had made a determination of gift tax liability by reason of the amendment of the trusts (83-84; Pet. Ex. 2, 96-103); (3) that the gift tax had been assessed and paid pursuant to the Commissioner's determination (86, 104); and (4) that no suit for refund of the gift tax paid had been instituted by Cory (86). Cory's counsel offered to stipulate the facts as to the distribution of the income of the trusts, but the Commissioner declined to accept the offer (87).

Since the burden of proof was on the Commissioner, it follows that all facts as to which the record is silent should have been assumed by the Court to be favorable to Cory.

Unsupported Inferences by the Circuit Court of Appeals.

While expressly adopting our contention and approving the ruling of the Board that the burden of proof was on the Commissioner, the Circuit Court of Appeals in its opinion placed great emphasis on assumed facts which find no support in the record. In other words, after stating one rule,—the correct rule—that the burden of proof was on the Commissioner in the circumstances here disclosed, the Court below, in effect, applied a different rule,—a rule that if the Commissioner proved the existence of trusts in which a taxpayer had a reversionary interest and in which income was to be paid to or accumulated for persons related by blood or marriage to the taxpayer, the Court would infer the existence of all the other facts held by this Court to be necessary to justify a finding of taxability, unless the taxpayer should then go forward with evidence to contradict such inferences.

The Court thus inferred, utterly without support in the record, that: (a) "the taxpayer retained complete control over the trustee who was also apparently his attorney" (115), and (b) "the trust just as in the *Clifford* case merely

reallocated the income within an 'intimate family group'" (115).

This Court has held each of these factors to be important in making a determination of taxability in a case of this kind. Yet, as pointed out in our brief, the decision here as to what constitutes an "intimate family group" is completely inconsistent with the decisions in other Circuits, and the determination of "control" over the trustee is based upon an unwarranted inference from an unproved fact.

Provisions of the Trust Instruments.

The trust for Mrs. Cory provided that the income be distributed to her or accumulated for her in the sole discretion of the trustee and that any accumulated income should be paid to her not later than upon the termination of the trust or to her estate in the event of her death (26).

The trusts for Cory's three sons were identical in form and provided that the trustee should apply so much of the income (originally subject to certain limitations as to maximum amounts) as the trustee should see fit to the use of each of the sons, and that the income not so disbursed should be distributed to or accumulated for Mrs. Cory in the sole discretion of the trustee (36).

In all of the trust instruments, the trustee was given broad investment authority, subject only to Cory's reserved right (which was never exercised) to direct investment changes and the issuance of voting proxies (29, 38). Cory reserved no right to remove the trustee or to appoint another trustee except in the event of the original trustee's death or resignation (30, 40). The trustee neither died nor resigned. Except for the requirement that stock dividends be treated as principal, the trustee had absolute and uncontrolled authority to determine what receipts should be credited to income or principal and what expenses should be charged against either income or principal (31, 40-41).

The 1935 amendments to the trusts, which made them absolutely irrevocable (except with the consent of the beneficiaries) for an additional period of ten years, also provided that upon termination of each trust the principal would be distributed to Cory or his estate, and that Cory would have the right to change administrative provisions, but not to change the distributive provisions or affect the beneficial interests except with the consent of the beneficiaries (47, 51). The record fails to show that Cory ever exercised even the power to change administrative provisions. Nor did he in fact ever do so. All of the amendments to the trusts were placed in evidence and there were no amendments subsequent to January 8, 1935.

This reserved, but unexercised, power to change administrative provisions was the occasion for a serious error in the opinion of the Court below. The opinion relies heavily on the unsupported observation (115) that:

> "* * * he (Cory) could control the purse strings through his power to change, modify or alter any of the administrative provisions of the agreement. By this provision the settlor subtly reserved complete dominion over the trustee, since the trustee's appointment and powers are administrative."

The extent of this unexercised power is more fully analyzed in the supporting brief, but the unjustified character of the quoted conclusion is shown when we note that a maximum exercise of the power to change administrative provisions could not possibly alter the disposition of even a penny of either income or principal. Cory, therefore, certainly did not "control the purse strings". Yet this obvious error was a keystone of the Circuit Court's opinion.

II.

Jurisdiction.

The final decree of the Circuit Court of Appeals is dated March 12, 1942 (118). Petition for certiorari is brought pursuant to Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (Act of Cong. Feb. 13, 1925, c. 229, §1; 43 Stat. 938; 28 U. S. C., §347).

III.

Question Presented.

The sole question on this appeal is whether the Circuit Court of Appeals was justified in deciding that the "benefits" retained by the grantor were such that he remained in substance the owner of the trust property and therefore taxable on the income thereof, the burden of proof on this issue being on the respondent (the Commissioner).

This question requires a consideration of the subordinate questions, whether the rule enunciated by this Court in *Helvering* v. *Clifford*, 309 U. S. 331, should be extended to require taxability to the grantor of income from a trust (a) where the trust is irrevocable for ten years; (b) where the grantor is not the trustee, is not related to the trustee and has no control over the trustee; (c) where the grantor has no control over the distribution of income of the trust, and the independent trustee has absolute authority (1) to change investments without seeking the approval of the grantor, (2) to determine all questions of what should be credited to or charged against income or principal accounts, (3) to decide whether or to what extent income should be distributed to or accumulated for the beneficiaries (such decision in the case of three of the trusts affecting the question

of who would ultimately receive the income); (d) where the only permissible inference from the evidence is that the sons (for whose benefit three of the four trusts were created) were adult, emancipated and not members of an "intimate family group" as that term is commonly understood; (f) where approval of the rule enunciated by the Circuit Court of Appeals will effectively change the rule declared by this Court in the *Clifford* case as it has been generally understood and applied by other Circuit Courts of Appeals and by members of the Bar.

IV.

Reasons for Granting the Writ.

(1) ***The Decision of the Court Below Is in Substantial Conflict with the Reasoning of This Court in the Leading Case of Helvering v. Clifford, 309 U. S. 331, the Cases Following That Decision, and the Language of the Federal Statute on Which They Are Based.***

In the *Clifford* case, this Court announced a broad extension of the previously understood limits of liability under Section 22(a) of the Revenue Act of 1934,—an extension which the Commissioner of Internal Revenue himself had not even sought—an extension which prompted the dissenting minority to state that the decision disregarded "the fundamental principle that legislation is not the function of the judiciary but of Congress" (309 U. S. at 338). Yet, even under that extension of the rule, the majority went no further than to hold trust income taxable to the grantor in cases where, as in that case, "the benefits directly or indirectly retained blend so imperceptibly with the normal concepts of full ownership" that it is reasonable to find that the grantor "was the owner of the corpus for the

purposes of Section 22(a)". A finding that Cory continued to be the full owner of the trust property here involved violates all recognized principles of our property law. The trusts here were irrevocable for ten years (double the term involved in the *Clifford* case) unless sooner terminated by the death of the grantor or the survivor of four other persons. One trust was for the wife, as in the *Clifford* case, but the other three were for sons of the grantor, who, in spite of unwarranted inferences in the opinion below, must be regarded as emancipated adults who were no longer members of the grantor's "intimate family group".

The trustee here was independent (in contrast to the situation in the *Clifford* case where the grantor himself was trustee) and not subject to the control of the grantor except in minor ways which did not affect the absolute and irrevocable rights of the beneficiaries. The grantor's unexercised right to control investments was a reserved power which afforded the grantor only a modicum of protection against complete waste by the trustee of any principal that might revert to the grantor after ten years,—a period which was destined to include several years of world financial depression and additional unknown years of world conflict. The depression alone would have been enough to render any hope of reverter insecure; the addition of years of war—even successful war—may well make a reversion in 1945 utterly without value.

Section 22(a) permits taxability of trust income to the grantor only if the property producing the income is in effect owned by the grantor and that was the theory of this Court's decision in the *Clifford* case. Accordingly, the decision below can be justified only if the following proposition is correct: that a mere right of reverter in assets which, after a decade such as that in which we are now living, may have little or no value, plus an unexercised power to direct changes in investments, plus the satisfaction of benefiting independent blood relatives during the ten year

period, "blend so imperceptibly with the normal concepts of full ownership in the grantor" that he must be treated as the absolute owner.

(2) *This Case Involves Important and Novel Questions of Federal Law Which Have Not Been, but Should Be, Decided by This Court.*

The Court below expressly recognized (110) that it was handicapped in correctly determining the issues of this case by "the fact that the Supreme Court's decision (in the *Clifford* case) merely roughed in the broad outline of taxability and left the completion of the picture to future decisions". Indeed, the Court below placed considerable emphasis upon the unsettled limits of the rule in the *Clifford* case concerning which it quoted one writer to the effect that: "few tax problems in recent years have caused as much litigation as this one decision" (110).

The Circuit Court of Appeals for the First Circuit has also recently commented upon the need for further interpretation by this Court of the scope of the rule enunciated in the *Clifford* case. In *Commissioner* v. *Bateman,* 127 F. (2d) 266 (decided April 7, 1942), that Court said at page 271:

> "Frankly we do not know how the Supreme Court would apply the general criteria of the Clifford case to the facts now before us. We have to make our decision with such light as is available to us. * * *"

The Court then carefully reviewed the decisions of this Court and the decisions of various Circuit Courts of Appeals on the same question and added at page 274:

> "This review of the cases still does not indicate to us as clearly as we should wish how the case at bar should be decided."

With obvious misgivings and doubts as to what the correct rule is, the Circuit Court of Appeals in that case then held certain income of a trust not taxable to the grantor, although such income was being accumulated expressly subject to the grantor's power of appointment by will.

In the *Clifford* case, this Court justified its liberalized interpretation of Section 22(a) by the presence of three factors: "the short duration of the trust, the fact that the wife was the beneficiary, and the retention of control over the corpus by respondent" (309 U. S. at p. 335). The questions have been frequently raised but never authoritatively answered:

> " 'How short must be the term of the trust—5 years, 10 years, 15 years, for life? How close must be the familial relationship of the beneficiary—adult son, uncle? How extensive must be the grantor's control? How many of these factors need be present and in what combinations?' Surrey, The Supreme Court and The Federal Income Tax: Some Implications of Recent Decisions, 35 Illinois Law Review 779, 807." [Quoted among a number of other similar excerpts in footnote 11 to the opinion of the Court below (111).]

The present case offers an excellent vehicle for authoritative settlement of these questions by this Court since it involves double the term of the *Clifford* case, much less close family relationship, incomparably less control of the corpus by the grantor and correspondingly greater powers vested in an independent trustee.

Indeed, the decision below is apparently based upon a greatly simplified rule,—a rule that all trusts which may terminate short of a lifetime and which benefit blood relatives of the grantor must be disregarded for tax purposes. We do not believe that is the correct rule or the rule in-

tended by this Court, but we do submit that orderly administration of the tax laws requires that the question be determined by this Court.

(3) ***Questions Decisive in the Present Case Have Been the Subject of Clearly Conflicting Decisions in Different Circuit Courts of Appeals.***

The relative importance of the three factors which the rule in the *Clifford* case made decisive of taxability in family trust cases has been the subject of great controversy and divergence of decision in the various Circuit Courts of Appeals. The cases are discussed in more detail in the brief in support of this petition, but a summary of the range of conflict with respect to each factor is as follows:

(a) *Duration of the trust*: The decision below in this case held a term in the alternative of ten years or life to be a short-term trust. The Second Circuit Court of Appeals reached an opposite conclusion as to a ten year term in *Commissioner* v. *Jonas*, 122 F. (2d) 169. The First Circuit Court of Appeals, in *Commissioner* v. *Branch*, 114 F. (2d) 985, and the Second Circuit, in *Helvering* v. *Palmer*, 115 F. (2d) 368, similarly held that trusts for the lifetime of the beneficiaries—the grantor's wife in each case—were not short-term trusts and not taxable to the grantors under the *Clifford* rule.

(b) *Degree of relationship between grantor and beneficiary*: The Court below inferred that all four trusts here involved were for the benefit of the grantor's "intimate family group" although the only evidence offered by the Commissioner (upon whom the burden of proof rested in this case) was that the beneficiaries were the wife and three sons, respectively. The effect of this decision is that the

following facts, which must be assumed on this record, viz., the absence of a legal obligation to support, the fact that proceeds of the trust income were not used for maintenance or support, and the status of the grantor's sons as emancipated adults, are all immaterial in determining taxability under the *Clifford* rule.

In contrast, the Seventh Circuit Court of Appeals in *Commissioner* v. *Armour,* 125 F. (2d) 467 (February 2, 1942), flatly held that a married daughter, who was an only child with no children of her own and who was thirty-four years of age, was not a member of her mother's "intimate family group" so as to make the trust established by the mother for her benefit one taxable to the mother under the *Clifford* rule. The Sixth Circuit Court of Appeals has also emphasized the importance of proof of family solidarity (disregarded by the Third Circuit in this case) in holding not taxable to the grantor the income from trusts for the benefit of his wife and stepsons where it did not appear that such income was necessary for the support of the beneficiaries. *Suhr* v. *Commissioner,* 126 F. (2d) 283 (March 5, 1942).

(c) *Grantor's "control" of the trust property*: The Court below has held that the control retained by Cory was comparable to that considered by this Court in the *Clifford* case. The following chart shows the almost complete dissimilarity of the two cases in this respect:

Facts	*Clifford*	*Cory*
Was grantor trustee?	**Yes**	**No**
Did grantor control distribution of income?	**Yes**	**No**

Facts	*Clifford*	*Cory*
Investment and voting control	Solely in grantor as trustee	In independent trustee. Grantor had right to direct but did not exercise it.
Were grantor's powers of investment and voting control exercised?	Yes	No
Was grantor's approval necessary for sales or investments?	Yes, because he was the sole trustee	No
Could securities be held in grantor's own name?	Yes	No
Did grantor collect income?	Yes	No
Did grantor have power to compromise claims?	Yes	No
Was grantor protected against any liability except for bad faith?	Yes	No

The decision below is also in conflict with the First and Second Circuit Courts of Appeals as to the element of con-

trol which is requisite to bring a case within the *Clifford* rule. Far greater control was retained by the grantors of the trusts involved in *Commissioner* v. *Branch,* 114 F. (2d) 985 (C. C. A. 1st), *Commissioner* v. *Bateman,* 127 F. (2d) 266 (C. C. A. 1st), and *Palmer* v. *Commissioner,* 40 B. T. A. 102 (1939), affirmed without opinion on authority of *Commissioner* v. *Branch* in *Helvering* v. *Palmer,* 115 F. (2d) 368 (C. C. A. 2d). In all of these cases the trusts involved were held not taxable to the grantor.

Wherefore, your petitioner, referring to the attached brief in support of the foregoing reasons for granting the writ, respectfully prays that this Honorable Court issue a writ of certiorari, directing the United States Circuit Court of Appeals for the Third Circuit to certify and send to this Court a full and complete transcript of the record herein, to the end that the said case may be reviewed and determined by this Court as provided by law, and that the judgment of the United States Circuit Court of Appeals for the Third Circuit may be reversed, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

And your petitioner will ever pray.

Robert H. Cory,
Petitioner.

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ROBERT H. CORY,

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—against—

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Respondent.

BRIEF IN SUPPORT OF PETITION

I.

Opinions Below.

The opinion of the Circuit Court of Appeals (108-117) is officially reported in 126 F. (2d) 689.

The opinion of the Board of Tax Appeals (6-11) is not officially reported.

II.

Jurisdiction and Statement of Case.

The basis of this Court's jurisdiction and facts of the case are stated under headings I and III of the petition, and, in the interest of brevity, those statements are hereby incorporated in and made a part of this brief.

III.

Specification of Errors.

1. The Circuit Court of Appeals erred in holding a trust, which was irrevocable for ten years or in the alternative for life, to be a "short-term" trust within the meaning of the rule enunciated by this Court in *Helvering* v. *Clifford,* 309 U. S. 33.

2. The Circuit Court of Appeals erred in holding that emancipated adult sons of a grantor of a trust are members of the grantor's "intimate family group" under the rule of the *Clifford* case.

3. The Circuit Court of Appeals erred in holding that an unexercised power to change administrative provisions of a trust agreement gives a grantor complete dominion over the trustee and control over the income of the trust.

4. The Circuit Court of Appeals erred in holding that a reserved power to appoint a substitute trustee in the event, and only in the event, of the death or resignation of the original independent trustee gives the grantor power to appoint himself such substitute trustee and gives him control over the corpus of the trust within the meaning of the rule enunciated by this Court in *Helvering* v. *Clifford.*

5. The Circuit Court of Appeals erred in extending the rule of *Helvering* v. *Clifford* to a case involving a ten-year term, an independent trustee and complete absence of control by the grantor over determination of what is income and where the income shall be distributed.

IV.

Argument.

The statute involved is Section 22(a) of the Internal Revenue Acts of 1934 (c. 277, 48 Stat. 680, U. S. C., Title 26,

Sec. 22), and 1936 (c. 690, 49 Stat. 1648), which provided in part as follows:

> "*Sec. 22. Gross Income.*
>
> "(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * "

The leading case relied on by the Court below, is *Helvering v. Clifford*, 309 U. S. 331, which held that income from a "short-term" trust is taxable to the grantor under this statute where the beneficiaries are members of the grantor's "intimate family group" and where the grantor retains "control" of the corpus.

A.

A trust which for 10 years deprives the grantor of all benefits, while subjecting him to the risk of complete loss of the trust property, cannot reasonably subject the grantor to the same presumptions of continued ownership as a "short-term" trust.

The trusts involved in this case were irrevocable for a term in the alternative of ten years or life. The decision below is that such a trust is a "short-term" trust and accordingly subjects the grantor to the presumption of con-

tinued ownership. This decision, we submit, is inconsistent with the rule as heretofore declared by this Court and unrealistically fails to recognize the risks attendant upon tying up property in trust for as long and unforeseeable a period as ten years.

Both the Congress and this Court have refrained from declaring an inflexible rule as to just where the line should be drawn between trusts classified as "short-term" and trusts classified as "long-term". In *Helvering* v. *Hormel*, 312 U. S. 552, and *Helvering* v. *Richter*, 312 U. S. 561, this Court considered a three-year trust and a five-year trust and remanded both cases to the Board for further consideration. Those decisions are based upon the view that apparently even a three-year or a five-year term is not so short as to indicate conclusively that the income should be taxed to the grantor, in the absence of strong evidence respecting other factors. The *Clifford* case involved a five-year trust, and this Court has not held any grantor taxable under the rule of that case upon the income of any trust for a longer term.

It is interesting to compare the British solution of this difficulty, as their experience has resulted in the adoption of a statutory rule of thumb. Under the British income tax law, the income of a trust for a term of six years or less is automatically taxable to the grantor and the income of trusts for longer terms is not (12 & 13 Geo. 5, ch. 17, §20; L. R. Stat., Vol. 60, p. 373).

In the absence of a six-year rule of thumb, it is clear, we submit, that a ten-year term deprives the grantor of so many of the benefits of full ownership that he should not be treated as the owner for income tax purposes in the absence of much stronger evidence of control and intimate family relationship with the beneficiaries than would be sufficient in the case of a "short-term" trust of five or six years and than was present in this case.

B.

Where the burden of proof is on the Commissioner, as it was in this case, evidence that the trust beneficiaries were the wife and three sons of the grantor is insufficient to establish that grantor and beneficiaries were members of an "intimate family group".

There is no presumption that a man's adult son is a member of his "intimate family group". Yet the decision below is apparently based upon such a presumption. Although the learned Court below conceded that the normal burden of proof was reversed in this case,—that the Commissioner had the burden of proving that the beneficiaries were members of the grantor's "intimate family group"—it held that the Commissioner's burden was satisfied by showing "that the beneficiaries were members of the taxpayer's family" (117). It went even further and suggested that the burden was on the taxpayer to show that the beneficiaries were "hostile" if he wished to rely on the claim that they were not members of the grantor's "intimate family group" (117).

There is not one word in the opinion of this Court in the *Clifford* case, or in any other case we have found, which justifies such an interpretation. To say that an emancipated adult son is a member of his father's "intimate family group" unless they are "hostile" to each other, even if the son has a family of his own, a home of his own and an independent income of his own, deprives the phrase "intimate family group" of its normal, natural, generally understood meaning. To say that a grantor of a trust is taxable on the trust income unless the beneficiaries are "hostile" to the grantor is equivalent to saying that all trust income shall be taxable to the grantor, for it is unreasonable to suppose that any person would voluntarily set up a valuable trust for the benefit of his enemies, whether related to him or not.

Even if it could be presumed that the sons were members of this grantor's "intimate family group" at the time the trusts were originally set up in 1929, there could be no presumption that such relationship continued six or seven years later. Indeed, the dissolution of such intimate family groups is a normal development in the American way of life and perhaps particularly so in the case of sons who upon becoming adults seek to make their own way in the world and form new intimate family groups of their own. If the burden of proof had been on the petitioner then it would have been incumbent on him to show that the relationship did not exist in this case during the years under review. However, the burden of proof was admittedly on the Commissioner and no attempt whatsoever was made by the Commissioner to sustain the burden of showing that such a relationship did exist.

If the membership of trust beneficiaries in an "intimate family group" is to be retained as a factor in the determination of taxability of trust income to the grantor, this Court should speedily correct the error of the Court below in treating that phrase as merely a synonym for non-hostility. The term "intimate" was advisedly chosen by this Court in its decision in the *Clifford* case and implies that an additional element beyond mere family relationship must exist. The opinion of the Court below completely disregards this important factor.

Other Circuit Courts of Appeals have been more realistic in determining the existence or non-existence of an "intimate family group" relationship.

Commissioner v. *Armour,* 125 F. (2d) 467 (7th Circuit, Feb. 2, 1942), held a thirty-four year old married daughter, who lived apart from her mother, but had no children of her own, not a member of her mother's "intimate family group" under the rule of the *Clifford* case.

Suhr v. *Commissioner,* 126 F. (2d) 283 (6th Circuit, March 5, 1942), held not taxable to the grantor income from trusts for the benefit of his wife and stepsons where it did not appear that such income was necessary for the support of the beneficiaries.

In *Commissioner* v. *Central National Bank of Cleveland,* 119 F. (2d) 470 (6th Circuit, 1941), the Court considered the taxability of income from four trusts for the benefit of the wife and children of the settlor. Because taxability under Section 22(a) had not been urged before the Board of Tax Appeals, the Circuit Court remanded the case to the Board so that additional evidence could be introduced (among other subjects) "as to the individual status of members of the Wilson family bearing importantly upon the question whether they constituted an intimate family group". That case apparently presented the usual situation in which the burden of proof was recognized by both sides as being on the taxpayer and therefore the opportunity was given to the taxpayer to present such additional evidence after the case had been remanded. The case is on all fours with the case at bar except that here the burden of proof is admitted by the Court below to be on the Commissioner, who knew he was urging taxability under Section 22(a) at the time of the trial in the Board of Tax Appeals and failed to present any evidence as to the existence of an "intimate family group" other than the exact evidence which was held inconclusive in the *Central National Bank* case, viz., evidence that the beneficiaries were the wife and children of the grantor.

Commissioner v. *Chamberlain,* 121 F. (2d) 765 (2d Circuit, 1941), held not taxable to the grantor income from an almost wholly controlled four-year trust for the benefit of a Legislative Drafting Research Fund of Columbia University in which both the grantor and his co-trustee were professors and intensely interested. The Court's opinion emphasized

the absence of benefit to "immediate relatives" and the non-existence of a "family purpose". There was no suggestion that hostility between the grantor and beneficiary must be shown to take the case out of the *Clifford* rule.

The conflict between those decisions and the decision of the Third Circuit, which is the subject of this petition, should be resolved by this Court before the confusion already created results in an unnecessary volume of additional litigation.

C.

The Court below has erroneously confused control by the grantor over administrative provisions of the trust with that type of control over the distribution of income which is an important factor in determination of taxability under the rule of the Clifford case.

The facts respecting the "control" retained by Cory in the present case and a comparison demonstrating the much greater and more important control retained by Clifford in the leading case in this Court have been set forth in the petition (pp. 13-14, *supra*), and for the sake of brevity will be omitted here. It will be recalled that Clifford retained complete control over the distribution of income during the period of the trust while Cory gave up all vestiges of such control. The fact that Cory retained power to change the administrative provisions of the trust appears to have led the Court below into the erroneous statement (115) that through such power "he could control the purse strings * * *" The Court agreed implicitly that the only sort of control which is important in the present situation is control of "the purse strings". Certainly that is the theory of cases in other Circuit Courts of Appeals which have discussed the "control" factor.

Jones v. *Norris,* 122 F. (2d) 6 (C. C. A. 10th, 1941);
Commissioner v. *Branch,* 114 F. (2d) 985 (C. C. A. 1st, 1940);
Palmer v. *Commissioner,* 40 B. T. A. 1002, aff'd without opinion in *Helvering* v. *Palmer,* 115 F. (2d) 368 (C. C. A. 2d, 1940);
Whitely v. *Commissioner,* 120 F. (2d) 782 (C. C. A. 3d, 1941);
Commissioner v. *Buck,* 120 F. (2d) 775 (C. C. A. 2d, 1941).

Likewise, the power to appoint a substitute trustee in the event of death or resignation of the original independent trustee has been held unimportant in determining taxability under the rule of the *Clifford* case. *Commissioner* v. *Jonas,* 122 F. (2d) 169 (C. C. A. 2d, 1941).

The opinion of the Court below appears to have been erroneously based upon the assumption that by changing the administrative provisions of the trusts involved in this case, Cory might have forced a diversion of the income to persons or for purposes different from those specified in the trust agreements. Such assumption was plainly erroneous since it disregards the limitation upon Cory's power to change administrative provisions imposed by the same sentence of the trust agreement, which granted the power (47):

> "* * * but he (Cory) shall not have the power at any time to change the distributive provisions or to affect the beneficial interests created hereunder * * *."

In any event, recognized principles of trust law would be invoked to curb an abuse of trust purposes through a settlor's reckless use of reserved powers for his own benefit. In *Carrier* v. *Carrier,* 226 N. Y. 114, which involved a trust

reserving to the settlor far more extensive control than was retained by Cory here, it was made plain in the opinion of Judge (later Mr. Justice) Cardozo that such reserved powers are themselves held in a fiduciary capacity and must be exercised subject to the same equitable principles as are applicable to the independent trustee (in that case a trust company; here an individual). The Court there said, at page 125:

> "* * * the creator of this trust had reserved to himself the broadest rights of management. His discretion was to be 'absolute and uncontrolled.' That does not mean, however, that it might be recklessly or willfully abused. He had made himself a trustee; and in so doing he had subjected himself to those obligations of fidelity and diligence that attach to the office of trustee. He had power to 'invest' the moneys committed to his care. He had no power, under cover of an investment, to loan them to himself. His discretion, however broad, did not relieve him from obedience to the great principles of equity which are the life of every trust (citing cases)."

The petition for a writ of certiorari should be granted.

Respectfully submitted,

PETER V. D. VOORHEES,
SAMUEL B. STEWART, JR.,
Counsel for Petitioner.

Dated: June 9th, 1942.

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No. 133

In the Supreme Court of the United States

October Term, 1942

Robert H. Cory, petitioner

v.

Guy T. Helvering, Commissioner of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 6-11) is unreported. The opinion of the Circuit Court of Appeals (R. 108-117) is reported at 126 F. (2d) 689.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 12, 1942. (R. 118.) Petition for a writ of certiorari was filed June 9, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer created four trusts for the benefit of his wife and his three sons, respectively. The duration of each trust, as amended, was restricted to ten years, or to the death of the taxpayer, or to the death of the survivor of the taxpayer's wife and the sons, whichever should occur first. Upon termination, the principal was to be paid over to the taxpayer or to his estate. The trustee was required to invest the principal and give voting proxies on all stocks held, in such manner as taxpayer might direct. Is the taxpayer accountable under Section 22 (a) of the Revenue Acts of 1934 and 1936 for the 1935 and 1936 income of the trusts?

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set out in the Appendix, *infra*, pp. 10–15.

STATEMENT

The Board of Tax Appeals found the following facts (R. 6–9):

On April 6, 1929, taxpayer created four revocable trusts, one for the benefit of his wife and the others for the benefit of his three sons, one for each son. One Clinton H. Blake was made trustee of each trust. (R. 6.)

The trust for the wife provided that the income thereof was to be paid over to her during her life in the trustee's discretion. Any income not so

paid over to her was to go to her upon the termination of the trust, or to her estate upon her death. Upon her death the principal was to be paid over to taxpayer, or, if he were dead to be divided into shares and held in trust for taxpayer's living issue on terms and conditions not here material. The corpus of this trust consisted of stock in the O'Sullivan Rubber Company and Lamont, Corliss & Company (R. 6–7).

In each of the trusts for the sons the trustee was to pay over to the beneficiary such portions of the income of the trust as should in the judgment of the trustee be necessary or desirable for the beneficiary's education, maintenance and support, not to exceed $3,000 in any year if the total income were $9,000 or less, but if the total income exceeded $9,000, $3,000 plus half of any excess. The balance of the income was payable to taxpayer's wife in the wisdom of the trustee. After the first beneficiary, i. e., the son, reached the age of 21 he was to be paid $3,000 yearly plus half of any excess of income over $9,000. When he reached 25, he was to receive one-fourth the principal and half the income; when he reached 30, he was to receive one-third of the remaining principal and one-half the income; and when he reached 35 he was to receive all the principal. Any undisposed of income was to be paid to taxpayer's wife. Should the son die before receiving the entire principal, the principal was to be paid over to tax-

payer, or to his wife if he should be dead, or to the son's next of kin if both taxpayer and his wife should be dead. The corpora of these trusts consisted of stock in Pond's Extract Company and Pond's Extract International, Ltd. (R. 7.)

Each trust contained the following provision (R. 7-8, 29, 38):

> The Trustee is hereby authorized to retain any property received by him hereunder in the form of investment in which such property is received, although such property be not of the character of investments permitted to trustees by law, and the Trustee shall during the life of Mr. Cory retain, dispose, invest, reinvest and otherwise deal with the principal of the trust fund, and shall issue voting proxies on all stocks held, in such manner as Mr. Cory may direct, regardless of the restrictions imposed by law upon trustees. The Trustee may retain as permanent investments of the trust or trusts any assets forming part of the original principal hereof, or forming part of the principal at the time of Mr. Cory's death, and may at all times invest and reinvest the principal of the trust in such forms of investment as he may deem expedient, (subject, however, to the directions of Mr. Cory during his lifetime) any legal restrictions upon trustees and investment of trust funds notwithstanding.

Each trust also contained this provision (R. 8, 30, 40):

> If Mr. Blake shall cease to serve as Trustee hereunder for any reason, The Citizens National Bank and Trust Company of Englewood is hereby appointed to act as substitute trustee, provided, however, that Mr. Cory reserves the right to revoke such appointment and to designate another substitute trustee at any time not later than sixty days after Mr. Blake shall cease to serve as Trustee, in which event the aforesaid Bank waives any rights to commissions.

It was further provided in each trust that stock dividends should constitute principal, but that in all other instances the trustee in his sole discretion should determine what receipts were principal and what were income and what expenses should be charged against either principal or income. (R. 8, 31, 40–41.)

On January 8, 1935, taxpayer *amended* all four trusts. Their duration was now restricted to ten years, or to the death of taxpayer, or to the death of the survivor of taxpayer's wife and the children, whichever event should first occur. (R. 45, 49.) Upon the termination of the trust the principal was to be paid over to taxpayer or to his executor or administrator. (R. 8–9.) In addition each trust was amended so as to contain the following (R. 9, 47, 51–52):

> Mr. Cory shall have the right at any time during the term of the trust by written instructions delivered to the Trustee, to change, modify or alter any the administra-

> tive provisions of this agreement but he shall not have the power at any time to change the distributive provisions or to affect the beneficial interests created hereunder or to revoke this trust in whole or in part or to revest in himself title to any part of the corpus of the trust, except that he shall have such powers or any of them with the consent of the beneficiary or beneficiaries currently entitled to the income hereunder. No part of the income of the trust shall be distributed to Mr. Cory or be held or accumulated for future distribution to him or applied to the payment of premiums upon policies of insurance upon his life. Upon the termination of the trust no part of the income theretofore accumulated by the Trustee, pursuant to the provisions hereinabove contained, shall be payable to Mr. Cory, but all such accumulated income shall be paid to the beneficiary entitled thereto.

The Commissioner taxed to the grantor the income of the trusts for 1935 and 1936.[1] Upon review, the Board of Tax Appeals sustained the Commissioner's action. (R. 5, 6–11.) The Circuit Court of Appeals affirmed. (R. 108–117, 118.)

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[1] The explanation given in the deficiency letters was that the trusts were revocable trusts whose income was taxable to the grantor under Section 166 of the Revenue Acts of 1934 and 1936. (R. 24, 62.) At the trial before the Board the Commissioner amended his answers to allege (R. 73–74) that the income of the four trusts was taxable to the taxpayer under the provisions of Section 22 (a) of the Revenue Acts of 1934 and 1936. Taxpayer expressly entered "no objection" to these amendments. (R. 74.)

ARGUMENT

Both the Board of Tax Appeals and the court below correctly ruled that the grantor was taxable upon the income of the four trusts under the principles of *Helvering* v. *Clifford,* 309 U. S. 331. As amended, the trusts had a maximum duration of ten years; the income was to be distributed to member's of the grantor's immediate family; the corpora were to be restored to the grantor upon termination of the trusts; and substantial control over the administration of the trusts was reserved to the grantor in that he could direct trust investments, vote the stock held in trust, change any of the administrative provisions of the trust agreements, and name successor trustees.

Although some factual differences obviously exist between this case and the *Clifford* case, they are in essence the same. The taxpayer, while retaining substantial control over his property, has deflected income therefrom for a fixed period to members of his immediate family. The principles requiring the taxpayer to account for such income have been applied in many cases presenting a variety of factual backgrounds. E. g., *Hormel* v. *Helvering,* 312 U. S 552; *White* v. *Higgins,* 116 F. (2d) 312 (C. C. A. 1st); *Commissioner* v. *Berolzheimer,* 116 F. (2d) 628 (C. C. A. 2d); *Commissioner* v. *Buck* 120 F. (2d) 775 (C. C. A. 2d); *Commissioner* v. *Barbour,* 122 F. (2d) 165 (C. C. A. 2d); *Helvering* v. *Elias,* 122 F. (2d) 171 (C. C. A. 2d); *Commissioner*

v. *Lamont* (C. C. A. 2d), decided April 24, 1942, not yet officially reported but may be found in 1942 Prentice-Hall, Vol. 4, par. 62,686; *Whiteley* v. *Commissioner,* 120 F. (2d) 782 (C. C. A. 3d), certiorari denied, 314 U. S. 657. Cf. *Helvering* v. *Richter,* 312 U. S. 561; *Commissioner* v. *O'Keeffe,* 118 F. (2d) 639 (C. C. A. 1st); *Commissioner* v. *Ward,* 119 F. (2d) 207 (C. C. A. 3d); *Commissioner* v. *Brown,* 122 F. (2d) 800 (C. C. A. 3d); *Commissioner* v. *Central Nat. Bank,* 119 F. (2d) 470 (C. C. A. 6th); *Commissioner* v. *Goulder,* 123 F. (2d) 686 (C. C. A. 6th). See also *Helvering* v. *Horst,* 311 U. S. 112; *Helvering* v. *Eubank,* 311 U. S. 122; *Harrison* v. *Schaffner,* 312 U. S. 579.

The fact that the trusts herein might last ten years does not change the result. The *Clifford* case has been regarded as applicable in cases of trusts having comparable potential duration. See *Commissioner* v. *Berolzheimer, supra; Commissioner* v. *O'Keeffe, supra.* Cf. *Helvering* v. *Fuller,* 310 U. S. 69, 76.

Petitioner suggests conflicts with various cases in which the courts have refused to apply the *Clifford* case. *Commissioner* v. *Branch,* 114 F. (2d) 985 (C. C. A. 1st); *Commissioner* v. *Bateman,* 127 F. (2d) 266 (C. C. A. 1st); *Commissioner* v. *Chamberlain,* 121 F. (2d) 765 (C. C. A. 2d); *Commissioner* v. *Jonas,* 122 F. (2d) 169 (C. C. A. 2d); *Suhr* v. *Commissioner,* 126 F. (2d) 283 (C. C. A. 6th); *Commissioner* v. *Armour,* 125 F. (2d) 467 (C. C. A. 7th); *Jones* v. *Norris,* 122 F. (2d)

6 (C. C. A. 10th). But regardless of whether those decisions are correct, they are distinguishable from the instant case. Thus, life estates rather than ten-year trusts were involved in the *Branch, Bateman, Armour,* and *Suhr* cases. In the *Jonas* case, unlike the case at bar, the grantor had not reserved any control over the corpus, and the *Jonas* case has been regarded by the same circuit court of appeals in *Helvering* v. *Elias*, 122 F. (2d) 171, as turning upon the absence of control. The *Chamberlain* case involved a charitable beneficiary rather than a member of the grantor's family, and even the court which decided that case has since in effect receded from the position taken therein. *Commissioner* v. *Lamont* (C. C. A. 2d), April 24, 1942. Finally, *Jones* v. *Norris* involved a trust for twenty years, and the settlor had no reversion.

CONCLUSION

The case was correctly decided by the court below. There is no conflict of decisions. The petition should be denied.

Respectfully submitted,

Charles Fahy,
Solicitor General.

Samuel O. Clark, Jr.,
Assistant Attorney General.

Sewall Key,
J. Louis Monarch,
Warren F. Wattles,
Special Assistants to the Attorney General.

July 1942.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

Section 22 (a) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, contains same provisions as the above.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from

both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

* * * * *

ART. 166–1 [as amended by T. D. 4629, XV–1 Cum. Bull. 140, 141 (1936), and T. D. 4759, 1937–2 Cum. Bull. 117, 118]. *Trusts with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.*—(a) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(b) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the cor-

pus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trusts in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(c) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(d) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the

grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

Article 22 (a)-1 of Treasury Regulations 94, promulgated under the Revenue Act of 1936, contains the same provisions as the corresponding provisions of Treasury Regulations 86, above quoted.

The provisions of Article 166-1 of Treasury Regulations 94, as amended by T. D. 4759, *supra*, are the same as the corresponding provisions of Treasury Regulations 86, above quoted.

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